

MUNICIPAL BUSINESS TAXES

Title 35 RCW (see below)

Tax Base The statutes do not specify a particular measure for the taxes which may be levied upon businesses by municipalities. Traditionally, there have been four different types of tax bases that have been used:

- gross receipts or gross income;
- fees based on particular type of activity;
- fees based on number of employees; and
- fees based on floor space (square footage of buildings owned).

Tax Rate

GENERAL BUSINESS ACTIVITIES: RCW 35.21.710 imposes a maximum rate of 0.2 percent for city taxes on business activities that are measured by gross receipts or gross income. However, if a city levied a higher rate on January 1, 1982, the rate need not be reduced, but future increases were limited to a maximum of 10 percent (i.e. 0.22 percent) and the amount that the rate could be increased annually was 2 percent (i.e., 0.004 percent per year). The city may increase the tax rate above these maximums, if approved by the voters of the jurisdiction (RCW 35.21.711).

UTILITIES: RCW 35.21.870 imposes a maximum rate of 6.0 percent on electrical, natural gas, steam energy and telephone businesses, unless a higher rate is approved by the voters. Cities that levied a higher rate on April 20, 1982 were required to reduce the rate to 6.0 percent over a ten year period, unless the higher rate was approved by the voters. There is no limit on the rate for other utilities, e.g., garbage, water and sewer services.

OTHER REQUIREMENTS AND RATE LIMITS:

- Any license fee or tax on gross receipts/income that is imposed on retailing businesses must be levied at a single and uniform rate (RCWs 35.21.710 and 35A.82.050);
- Competitive telephone service must be taxed as a retailing activity which is limited to a rate of 0.2 percent (RCW 35.21.710 and 35A.82.050);
- Other telephone businesses operating within the city, if measured by gross receipts/income, must be taxed at a uniform rate which can be as high as 6.0 percent. The tax may apply to 100 percent of intrastate toll service. If the tax is levied on charges to other telecommunications companies for connection fees, switching charges, access charges, interstate service or network telephone service purchased for resale, such tax must be at the same rate which applies to competitive telephone service, i.e., a maximum of 0.2 percent. (RCWs 35.21.712, .714 and .715 and 35A.82.055, .060 and .065);

- Any license fee or tax on financial institutions is limited to the rate which applies to other service activities and the definitions, deductions and exemptions which pertain to the state B&O tax on financial institutions must also apply for the municipal tax (RCW 82.14A.010). The Department of Revenue is required to promulgate a rule defining the uniform apportionment of income of financial institutions for purposes of the local business taxes (RCW 82.14A.020); there are four rules which address this subject: WAC 458.28.010 – 458.28.040.
- Income of trucking firms is subject to allocation for purposes of determining the appropriate measure of local business taxes (RCWs 35.21.840-850).
- New taxes may not be imposed on Internet service providers until July 1, 2002 (RCW 35.21.717).

VOTER APPROVAL: After April 22, 1983, any new or increased municipal business and occupation tax is subject to a referendum procedure (RCW 35.21.706). This allows the filing of a referendum petition to challenge a new or increased tax within seven days of the imposing ordinance. After the ballot title is prepared, the petitioner has 30 days to collect signatures. If at least 15 percent of the population of the jurisdiction sign the petition, then the ordinance imposing or increasing the business tax will appear upon the next ballot for approval by the voters.

Administration City Clerk, Treasurer or other financial officer (e.g., Department of Revenue and Consumer Affairs in the City of Seattle).

Distribution of Receipts Not specified in statute; presumed to be used for general purposes of the municipality.

Exemptions None specified in statute.

Recent Collections

According to data reported by local governments to the State Auditor via the Budget, Accounting and Revenue System, municipal business taxes collected during calendar year 2000 amounted to \$622 million. Further breakdown of the city collections is as follows:

| | <u>Calendar 2000</u> | <u># Cities Reporting</u> |
|---------------------------------------|----------------------|---------------------------|
| General business and occupation tax | \$205,299,768 | 37 |
| Utility taxes on city's own utility | 125,224,544 | 66 |
| Utility taxes on private utilities | 243,869,354 | 200 |
| Utility taxes on government utilities | 32,463,432 | 88 |
| Utility consumer taxes | 15,120,754 | 85 |
| TOTAL CITY BUSINESS TAXES | \$621,977,851 | |

Levied by

Cities and towns only; counties are not authorized to levy B&O or utility taxes (although several counties levy a franchise fee on cable TV firms). The authority to levy municipal business taxes and license fees appears in several statutes in Title 35 RCW:

- RCW 35.21.710: General requirements for taxes measured by gross receipts and the 0.2 percent rate limit for all cities. (NOTE: this statute does not specifically state that cities may levy a business tax; rather it merely requires uniformity of rates on retailing and establishes the overall rate limit.)
- RCW 35.22.280: first class cities. The law lists many specific powers for cities with 20,000 or more residents at the time of incorporation. None of the various subsections specifically state that such cities may levy municipal business taxes. Subsection 2 allows cities to "provide for the payment of the debts and expenses of the (municipal) corporation." Subsection 32 allows cities to "grant licenses for any lawful purpose, and to fix by ordinance the amount to be paid therefor." RCW 35.22.570 grants first class cities all powers that are given to other cities by Title 35 RCW; this includes more specific authority for municipal business taxes.
- RCW 35.23.440(8): second class cities. This statute lists the powers of cities with populations ranging from 10,000 to 20,000 at the time of incorporation. This subsection permits a municipal license tax for purposes of revenue and regulation upon occupations, trades and all businesses.
- RCW 35.24.290(7): third class cities. The powers of cities with populations ranging from 1,500 to 10,000 at the time of incorporation include the authority to license all businesses for the purpose of regulation and revenue and to fix the rate of such license taxes.

- RCW 35.27.370(9): towns. This statute provides authority for municipal corporations with populations from 300 to 1,500 at the time of incorporation to license all businesses and fix the rates of such license taxes for purposes of regulation and revenue.
- RCW 35A.82.020 & .050: cities chartered under the optional municipal code. Authority is provided to such cities, regardless of size, to license businesses or impose excise taxes for purposes of regulation or revenue.

GENERAL BUSINESS TAXES

According to a survey of 279 municipalities by the Association of Washington Cities,¹ 37 cities currently levy a B&O tax on businesses which is measured by a percentage of the firm's gross receipts. The reporting cities were:

| | | |
|-------------------|------------------|------------|
| Aberdeen | Issaquah | Rainier |
| Algona | Kelso | Raymond |
| Bainbridge Island | Lacey | Roy |
| Bellevue | Lake Forest Park | Ruston |
| Bellingham | Long Beach | Seattle |
| Black Diamond | Longview | Shelton |
| Bremerton | Mercer Island | Snoqualmie |
| Buckley | North Bend | Tacoma |
| Cosmopolis | Ocean Shores | Tumwater |
| Darrington | Olympia | Vancouver |
| Dupont | Pacific | Westport |
| Everett | Port Townsend | Yelm |
| Hoquiam | | |

The average rates levied by the 37 cities were as follows:

| | | |
|----------------------|---|--------------|
| Retail businesses | - | 0.17 percent |
| Wholesale businesses | - | 0.15 percent |
| Manufacturing firms | - | 0.15 percent |
| Service firms | - | 0.21 percent |

¹Municipal Tax Rates and Fees, 2000 Survey, Association of Washington Cities.

In addition to the reported 37 cities using gross receipts, there were many municipalities that reported using another type of tax base for their annual municipal business tax or license fee. Some of these cities also levy the local B&O tax on gross receipts, in addition to an annual license fee. Also, there are a variety of additional fees on specific activities, such as home occupation licenses or fees for cabarets.

Approximately 170 cities levy business license fees. Most of these are comprised of a fixed dollar amount of license fee that is paid annually (some have an initial one-time license fee for registration). Many of these are fixed fees, often in the \$25 - \$75 range, while some vary the fee according to the type of business activity. Thirty-four cities reported measuring the annual business tax by the number of employees. Typically, they levy a fixed dollar amount, plus a graduated fee depending upon the firm's employment. Finally, six cities -- Anacortes, Bothell, Kennewick, Pasco, Sedro-Woolley, and Sequim -- reported using square footage of the business as a measure of the annual license fee.

UTILITY TAXES

The AWC survey identified cities that indicated they levied a municipal tax on one or more types of utilities. Four of these -- Kennewick, Pasco, Richland and Toppenish -- impose voter-approved utility rates on natural gas, electricity or telephone service above the maximum 6.0 percent. The types of utilities, the average tax rate and the number of cities reporting a utility tax were:

| <u>Type of Utility</u> | <u>Average Tax Rate</u> | <u># Reporting</u> |
|------------------------|-------------------------|--------------------|
| Natural gas | 5.47% | 122 |
| Electric | 5.54 | 172 |
| Telephone | 5.64 | 169 |
| Cellular telephone | 5.73 | 117 |
| Garbage | 6.95 | 118 |
| Water | 7.23 | 128 |
| Sewer | 7.44 | 119 |
| Storm drainage | 7.22 | 36 |
| Cable television | 5.58 | 112 |

In general, a municipal utility tax levied on a utility activity operated by the same city applies to all customers of that utility, even if they live outside the boundaries of the city. But a municipal utility tax levied upon privately-owned utility companies only applies to customers who reside within the city.

History

It is not known when cities first began taxing business activities within their jurisdiction. Presumably, they first imposed license fees of a specified dollar amount. The use of gross receipts as a measure of the municipal business taxes probably began sometime after the initial state gross receipts tax, the Business Activities Tax of 1933 (succeeded by the B&O tax in 1935). Limitation of rates to 0.2 percent for general business activities and 6.0 percent for utilities was enacted in 1982.

Discussion/Major Issues

Municipal business taxes are locally levied and collected. Unlike the property tax and the local sales tax, the state has no involvement in the administration of these taxes. There is little uniformity in tax rates and tax bases, which may be confusing for firms that do business in more than one city which levies a tax on general business activities.

The only statewide source of collection data for local business taxes is the annual reports made to the State Auditor as required by RCW 35.21.710, but this statute requires only reporting of taxes levied on retailers. There has been concern that not all cities have reported municipal business tax revenues and that the data may be incomplete, since it is not audited by the state.

The tax on general business activities has only been levied in a relatively small number of cities. Some cities, particularly those in Eastern Washington, have tried unsuccessfully to convince their voters to authorize the tax. In at least one instance, a local B&O tax was adopted by municipal ordinance but public sentiment forced its subsequent repeal.

Some problems have occurred for sales which cross jurisdictional boundaries. For example, it is not always clear which city has the authority to tax sales made by a firm located in one city that imposes a local B&O tax to customers located in another taxing jurisdiction. Under a “throwback” procedure, sales made to customers in jurisdictions which do not levy a tax (or are located in the unincorporated area of the county) have been taxed by the city from which the sale originated.